

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Unit Name Port Austin Area Sewer And Water Authority	County Huron
Fiscal Year End February 28, 2006	Opinion Date July 21, 2006	Date Audit Report Submitted to State August 30, 2006	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

- YES NO Check each applicable box below. (See instructions for further detail.)
- ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
 - ☒ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
 - ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
 - ☒ ☐ The local unit has adopted a budget for all required funds.
 - ☒ ☐ A public hearing on the budget was held in accordance with State statute.
 - ☒ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
 - ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
 - ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
 - ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
 - ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
 - ☒ ☐ The local unit is free of repeated comments from previous years.
 - ☒ ☐ The audit opinion is UNQUALIFIED.
 - ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
 - ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
 - ☒ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)	
Financial Statements	<input checked="" type="checkbox"/>		
The letter of Comments and Recommendations	<input type="checkbox"/>	Letter of Comments and Recommendations not issued - no items	
Other (Describe)	<input type="checkbox"/>		
Certified Public Accountant (Firm Name) Brining & Nartker, P. C.		Telephone Number (989) 269-9909	
Street Address 64 Westland Drive		City Bad Axe	State MI
			Zip 48413
Authorizing CPA Signature <i>Brining & Nartker, P.C. by Douglas Brining, CPA</i>		Printed Name Douglas Brining, CPA	
		License Number 08283	

**PORT AUSTIN AREA SEWER
AND WATER AUTHORITY
PORT AUSTIN, MICHIGAN**

**FINANCIAL REPORT
FEBRUARY 28, 2006 AND 2005**

**PORT AUSTIN AREA SEWER AND WATER AUTHORITY
BUSINESS-TYPE ACTIVITIES
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FEBRUARY 28, 2006 AND 2005**

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INDEPENDENT AUDITORS' REPORT

To the Authority Members
Port Austin Area Sewer and Water Authority
Port Austin, Michigan

We have audited the accompanying financial statements of the business-type activities of the Port Austin Area Sewer and Water Authority as of and for the year ended February 28, 2006 and 2005. These financial statements are the responsibility of the management of the Port Austin Area Sewer and Water Authority. Our responsibility is to express our opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Port Austin Area Sewer and Water Authority as of February 28, 2006 and 2005, and the respective changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 11, the Authority has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, as amended and interpreted, as of February 28, 2005.

Our audit was conducted for the purpose of forming an opinion on the business-type activities financial statements taken as a whole. The accompanying additional information, as identified in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. The additional information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



BRINING & NARTKER, P.C.
Certified Public Accountants

July 21, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

PORT AUSTIN AREA SEWER & WATER AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS FEBRUARY 28, 2006

Port Austin Area Sewer & Water Authority (PAASWA) is presenting the following discussion and analysis in order to provide an overall review of the utility's financial activities for the fiscal year ending February 28, 2006. We encourage readers to consider the information presented here in conjunction with the financial statements and notes to the basic financial statements in order to enhance their understanding of the utility's financial performance.

2006 FINANCIAL HIGHLIGHTS

- The utility's operating revenues decreased \$10,715 or 2.10% from 2005 to 2006. Decreased consumption and fewer new connections contributed to this decrease.
- The utility's operating expenses increased \$17,996 or 3.78% from 2005 to 2006. The increase was due to the engineering costs that were incurred for the plant upgrade. These engineering costs will be reimbursed with funds that will be received from the S2 Grant from the Michigan Department of Environmental Quality.
- The utility's total net assets decreased \$48,696 or 1.24% from the 2005 to 2006. This was due to the net loss posted for fiscal year ending February 28, 2006.

GENERAL INFORMATION ABOUT PAASWA

PAASWA was created in 1983 when the Village of Port Austin and Port Austin Township decided to construct a sewer system and wastewater treatment plant. EPA grants and a bond issue in the amount of \$2,225,000 were used to finance the project. Each property was assessed \$2,400 per REU to pay for the bond issue. In 2002 the interest rates decreased and it became feasible for PAASWA to reduce the debt. In November of 2005 the balance of the principal of the bond issue was paid in full thus leaving the authority with no debt.

In 1995 the Village of Port Austin water system was turned over to PAASWA. At that same time the Village of Port Austin bonded with USDA Rural Development to construct a 20 inch buried intake into Lake Huron. The total cost of the project was \$1,475,000 of which \$975,000 was financed through USDA Rural Development.

In January of 2002 PAASWA purchased the property at 76 W. Spring St. with the intent of constructing a new water plant. The formation of the Huron Regional Water Authority in December of 2002 removed the burden of constructing a new water plant. In August of 2004 the Huron Regional Water Authority purchased the water intake and the property from PAASWA by paying off the remaining principal.

PAASWA currently serves approximately 680 customers in the Village of Port Austin and approximately 50 customers in Port Austin Township.

PORT AUSTIN AREA SEWER & WATER AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS FEBRUARY 28, 2006

RATES

The utility last increased its commodity rate for water in March of 2003. An increase to the Ready-to-serve charge went into effect in June of 2003. The current rates charged by PAASWA are about average of any like sized utility (less than 1,000 customers).

UTILITY FINANCIAL ANALYSIS

The statements of Net Assets include all of the utility's assets and liabilities and provide information about the nature and amount of investments in resources and the obligations to creditors. This statement provides the basis for evaluations the capital structure and assessing the liquidity and financial flexibility of the utility.

A summary of the utility's Statement of Net Assets is presented in Table 1.

Table 1

Condensed Statements of Net Assets

	2005	2006
Current and Other Assets	\$190,150	\$183,216
Restricted Assets	505,799	354,420
Capital Assets	3,753,603	3,619,277
Total Assets	<u>4,449,552</u>	<u>4,156,913</u>
Debt Outstanding	166,762	108,622
Other Liabilities	351,800	165,997
Total Liabilities	<u>518,562</u>	<u>274,619</u>
Invested in Capital Assets		
Net of Related Debt	3,553,603	3,619,277
Restricted	540,420	188,423
Unrestricted	<u>(163,033)</u>	<u>74,594</u>
Total Net Assets	<u>\$3,930,990</u>	<u>\$3,882,294</u>

Net Assets decreased 1.24% in 2006 due to the net loss incurred during 2006. The only outstanding debt in 2005 was the balance of the sewer bonds that were paid off November 1, 2005. The deferred assessments will be received for the next 4 years.

PORT AUSTIN AREA SEWER & WATER AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS FEBRUARY 28, 2006

2005 OPERATING RESULTS

Table 2

Condensed Statements of Revenues, Expenses and Changes in Net Assets

	2005	2006
Operating Revenues	\$520,990	\$510,275
Non-Operation Revenues	186,690	62,834
Total Revenues	707,680	573,109
Operating Expenses	457,921	475,917
Depreciation Expense	173,682	139,138
Non-Operating Expense	49,670	6,750
Total Expense	681,273	621,805
Income Before Capital Contributions and Transfers	26,407	(48,696)
Capital Contributions Transfers - Tax Equivalent	153,831	
Changes in Net Assets	(127,424)	(48,696)
Beginning Net Assets	4,975,129	3,930,990
Adjustment to Net Assets	916,715	
Ending Net Assets	\$3,930,990	\$3,882,294

The utility's operating revenues decreased by \$10,715 or 2.1% in 2006. This is attributed to the lower usage and fewer connections made during the year. An average of eight new connections is realized per year. Depreciation expense decreased dramatically during 2006 due to the transfer of the intake to the Huron Regional Water Authority in 2004.

Revenue from investment income has decreased over the last few years due to the low interest rates. The income from late fees and penalties has remained relatively constant.

PORT AUSTIN AREA SEWER & WATER AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS FEBRUARY 28, 2006

Table 3

OPERATING REVENUES AND EXPENSES

	<u>2005</u>	<u>2006</u>
OPERATING REVENUES:		
User Fees	504,232	490,946
Other	<u>16,758</u>	<u>19,329</u>
Total Operating Revenue	<u>520,990</u>	<u>510,275</u>
 OPERATING EXPENSES:		
Contractual services:		
Management Services	414,924	409,332
Legal	3,097	3,359
Audit and Engineering	4,897	13,938
Board Fees	2,340	2,380
Insurance	21,455	21,559
Other	11,208	5,349
Depreciation	<u>173,682</u>	<u>139,138</u>
 Total Operating Expenses	<u>631,603</u>	<u>615,055</u>
 NET OPERATING INCOME(LOSS)	<u><u>\$(110,613)</u></u>	<u><u>\$(104,780)</u></u>

Revenues

Total revenues decreased from \$707,680 in 2005 to \$573,109 in 2006, a decrease of \$134,571 or 19.02%. This is largely attributed to the reimbursement from the Huron Regional Water Authority in the amount of \$119,168 for costs incurred on their behalf in 2005 which increased the revenues for that period. Thus the overall decrease in total revenues would be \$15,403 or 2.62%. The non-operating income is decreasing because the assessments for the sewer are almost paid in full. The amount of interest is decreasing because the outstanding principal balance is decreasing. Also as the outstanding principal amount decreases some of the residents are paying off the principal. To off-set the continued decrease in the assessment revenues the sewer rate was increased from \$6.04 to \$6.34 per 1,000 gallons effective March 1, 2006.

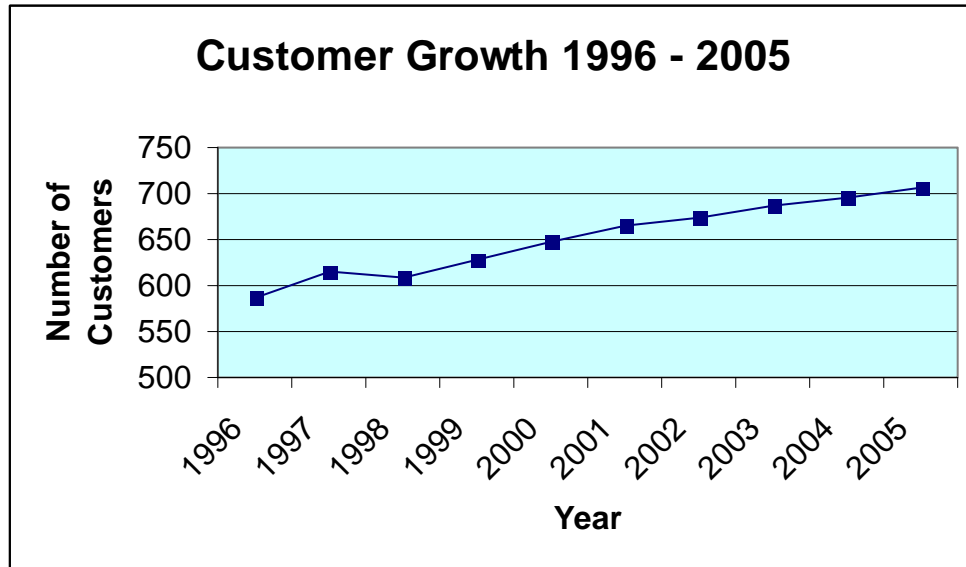
Expenses

Operating expenses totaled \$475,917 for 2006 compared to \$457,921 in 2005, an increase of 3.78%. This increase is due to the engineering costs for the proposed upgrade to the wastewater treatment plant and the cost of water purchased from the Huron Regional Water Authority, which is partially offset by the decrease in contract management fees. Operating expenses in 2002 were \$448,747 which is 6.05% lower than 2006. The Consumer Price Index, during the same period, increased 6.77%.

PORT AUSTIN AREA SEWER & WATER AUTHORITY

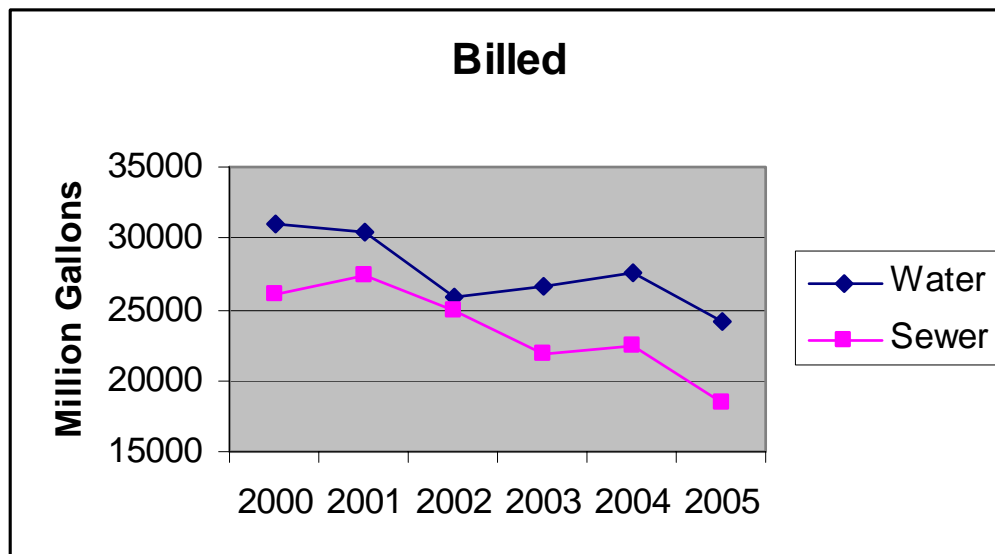
MANAGEMENT'S DISCUSSION AND ANALYSIS
FEBRUARY 28, 2006

Chart 1



The growth of customers has been steady for the last 10 years. The 588 customers the utility had in 1996 has grown to 706 in 2005. This is an increase of 20.07% over the last 10 years or 12 new customers per year. A large portion of the growth has been the development of Forest Creek Condominiums.

Chart 2



PORT AUSTIN AREA SEWER & WATER AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS FEBRUARY 28, 2006

You will note that even though the customer base has grown, the amount of water produced and billed out has dropped. This is due to the leak detection surveys that have been conducted on an annual basis.

PROJECTED CAPITAL EXPENDITURES

The PAASWA is being mandated by the Michigan Department of Environmental Quality to upgrade its wastewater treatment plant. The current plant has limited facilities for removing ammonia from the water that is discharged. The MDEQ has stipulated a time line for compliance. The preliminary engineering plans are to be submitted by March 1, 2006; the financial plan for funding the project must be submitted by October 1, 2006; and final completion of the project is to be December 31, 2007.

Preliminary projections from the engineering firm place the estimated total project cost between \$1.5 and \$5.0 million.

ECONOMIC FACTORS

PAASWA's service area is a resort town that has a year round population that has a high percentage of retirees on a fixed income. PAASWA also has a summer population that is double that of the year round population. A concern of PAASWA is the year round residents on a fixed income. Large rate increases could be a financial hardship on these customers.

Hume, Port Austin, and Pointe Aux Barques Townships border the PAASWA service area. All of these Townships have indicated they would like to become water customers of PAASWA. This will be a great benefit to the current PAASWA customers since it will spread the cost of the bonds for the Huron Regional Water Plant across many more users, thus lowering the cost to each customer.

UTILITY CONTACT INFORMATION

This financial report is designed to provide our customers and creditors with a general overview of the utilities finances and to demonstrate the utilities accountability for the funds it receives. Anyone having questions regarding this report or desiring additional information may contact the Port Austin Area Sewer and Water Authority, 8747 Hellems Rd., P.O. Box 367, Port Austin, Michigan 48475 or by phone at (989) 738-8366 or email at paaswa@airadvantage.net.

FINANCIAL STATEMENTS

PORT AUSTIN AREA SEWER AND WATER AUTHORITY
BUSINESS-TYPE ACTIVITIES
STATEMENT OF NET ASSETS
FEBRUARY 28, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 11,239	\$ 28,007
Receivables:		
Usage	87,683	76,718
Special assessment	34,154	34,621
Other	19,846	20,406
Inventory	13,987	13,988
Prepaid expense	16,307	16,410
TOTAL CURRENT ASSETS	<u>183,216</u>	<u>190,150</u>
NONCURRENT ASSETS:		
Investments-savings (restricted)	188,423	303,999
Special assessments (restricted)	165,997	201,800
Capital assets - net of accumulated depreciation	3,619,277	3,753,603
TOTAL NONCURRENT ASSETS	<u>3,973,697</u>	<u>4,259,402</u>
TOTAL ASSETS	<u>4,156,913</u>	<u>4,449,552</u>
<u>LIABILITIES</u>		
CURRENT LIABILITIES:		
Accounts payable	74,468	82,141
Current portion of deferred assessment revenue	34,154	34,621
Current portion of long-term debt	-	50,000
TOTAL CURRENT LIABILITIES	<u>108,622</u>	<u>166,762</u>
NONCURRENT LIABILITIES:		
Long-term portion of deferred assessment revenue	165,997	201,800
Bonds payable	-	150,000
TOTAL NONCURRENT LIABILITIES	<u>165,997</u>	<u>351,800</u>
TOTAL LIABILITIES	<u>274,619</u>	<u>518,562</u>
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	3,619,277	3,553,603
Restricted	188,423	540,420
Unrestricted	74,594	(163,033)
TOTAL NET ASSETS	<u>\$ 3,882,294</u>	<u>\$ 3,930,990</u>

The accompanying notes are an integral part of the financial statements.

**PORT AUSTIN AREA SEWER AND WATER AUTHORITY
BUSINESS-TYPE ACTIVITIES
STATEMENT OF REVENUES, EXPENSES AND
CHANGES IN FUND NET ASSETS
FOR THE YEARS ENDED FEBRUARY 28, 2006 AND 2005**

	<u>2006</u>	<u>2005</u>
OPERATING REVENUES:		
Charges for services	\$ 490,946	\$ 504,232
Other	19,329	16,758
TOTAL OPERATING REVENUES	<u>510,275</u>	<u>520,990</u>
OPERATING EXPENSES:		
Contractual services:		
Management services	409,332	414,924
Legal	3,359	3,097
Audit and engineering	13,938	4,897
Board fees	2,380	2,340
Insurance	21,559	21,455
Other	10,333	11,208
Depreciation	139,138	173,682
Water purchases - Huron Regional Water Authority	15,016	-
TOTAL OPERATING EXPENSES	<u>615,055</u>	<u>631,603</u>
OPERATING INCOME (LOSS)	<u>(104,780)</u>	<u>(110,613)</u>
NONOPERATING REVENUES (EXPENSES):		
Special assessments	42,942	40,948
Interest income	19,892	26,574
Interest expense	(6,750)	(49,670)
Reimbursement of prior costs incurred on behalf of the Huron Regional Water Authority	-	119,168
TOTAL NONOPERATING REVENUES (EXPENSES)	<u>56,084</u>	<u>137,020</u>
INCOME (LOSS) BEFORE TRANSFERS	<u>(48,696)</u>	<u>26,407</u>
TRANSFERS:		
Loss on transfer of net assets over debt to Huron Regional Water Authority	-	(153,831)
CHANGE IN NET ASSETS	<u>(48,696)</u>	<u>(127,424)</u>
NET ASSETS - BEGINNING OF YEAR	3,930,990	4,058,414
NET ASSETS - END OF YEAR	<u><u>\$ 3,882,294</u></u>	<u><u>\$ 3,930,990</u></u>

The accompanying notes are an integral part of the financial statements.

**PORT AUSTIN AREA SEWER AND WATER AUTHORITY
BUSINESS-TYPE ACTIVITIES
STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED FEBRUARY 28, 2006 AND 2005**

	<u>2006</u>	<u>2005</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers and users	\$ 500,337	\$ 520,647
Payments to suppliers	(483,487)	(451,510)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>16,850</u>	<u>69,137</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Reimbursement Huron Regional Water Authority	<u>-</u>	<u>119,168</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Interest expense	(6,750)	(49,670)
Payment of borrowing	(200,000)	(1,122,650)
Special assessments received	42,942	40,948
Acquisition of capital assets	(5,204)	-
NET CASH PROVIDED (USED) BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(169,012)</u>	<u>(1,131,372)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of investments	133,180	-
Purchase of investments	(17,678)	(122,932)
Net book value of assets transferred	-	1,214,631
Interest revenue	19,892	26,574
Loss on transfer of assets	-	(153,833)
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>135,394</u>	<u>964,440</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS DURING THE YEAR	<u>(16,768)</u>	<u>21,373</u>
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	28,007	6,634
CASH AND CASH EQUIVALENTS - END OF YEAR	<u><u>\$ 11,239</u></u>	<u><u>\$ 28,007</u></u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income (loss)	\$ (104,780)	\$ (110,613)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	139,138	173,682
(Increase) decrease in receivables	(9,938)	(343)
(Increase) decrease in prepaid expenses	103	(63)
Increase (decrease) in accounts payable	(7,673)	6,474
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u><u>\$ 16,850</u></u>	<u><u>\$ 69,137</u></u>

The accompanying notes are an integral part of the financial statements.

**PORT AUSTIN AREA SEWER AND WATER AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED FEBRUARY 28, 2006 AND 2005**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

A. DESCRIPTION OF AUTHORITY OPERATIONS

The Authority operates under an appointed board (four by the Village of Port Austin and one by Port Austin Township) and provides wastewater collection and treatment services to Village and Township residents and the surrounding area as authorized by its ordinance.

From 1981 through 1984, grant monies and construction were recorded in a construction fund of Port Austin Area Sewer and Water Authority. As of June 1983, assets constructed, along with related obligations, were transferred by action of the Authority to the enterprise fund, concurrent with initiation of facility operations.

As is discussed in Note 6, the Authority entered into a water supply system management contract with the Village of Port Austin, effective March 1, 1996, giving them management responsibility for 40 years.

B. REPORTING ENTITY

In accordance with the provisions of Governmental Accounting Standards Board (GASB) Statement No. 14, certain other governmental organizations are not considered to be part of the Authority entity for financial reporting purposes. The criteria established by GASB for determining the various governmental organizations to be included in the reporting entity's financial statements are discussed in the following paragraph.

The definition of the reporting entity is based primarily on the notion of financial accountability. A primary government is financially accountable for the organizations that make up its legal entity. It is also financially accountable for legally separate organizations if its officials appoint a voting majority of an organization's governing body and either it is able to impose its will on that organization or there is a potential for the organization to provide specific financial benefits to, or to impose specific financial burdens on, the primary government. A primary government may also be financially accountable for governmental organizations that are fiscally dependent on it.

On this basis, the financial statements of the Village of Port Austin, which operates autonomously, are not included in the financial statements of the Authority and the Authority is not considered to be a component unit of the Village.

C. BASIS OF PRESENTATION

The financial activities of the Authority are recorded in a fund categorized and described as follows:

PROPRIETARY FUND TYPE:

Enterprise Funds – Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises where the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis are financed or recovered primarily through user charges.

Property, Plant, and Equipment – Property, plant and equipment are stated at cost. Depreciation is provided on the straight-line basis over the estimated useful lives of the respective class of assets, ranging from 10 to 50 years.

Inventory – Inventory in the Enterprise Fund is valued at the lower of cost (first-in, first-out) or market. The cost is recorded as an expense at the time individual inventory items are consumed.

(Continued)

**PORT AUSTIN AREA SEWER AND WATER AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED FEBRUARY 28, 2006 AND 2005
(CONTINUED)**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: (Continued)

Restricted Investments and Assessments – A portion of the investments and special assessments of the Water System and Sewer System Funds are classified as restricted because their use is limited. The restrictions are due to bond resolution requirements or to segregate funds for specific purposes.

D. MEASUREMENT FOCUS

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the Statement of Net Assets. Fund equity (i.e., net total assets) is segregated into invested in capital assets (net of related debt), restricted and unrestricted components. Proprietary fund type operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

E. BASIS OF ACCOUNTING

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The proprietary funds are accounted for using the accrual basis of accounting. The revenues are recognized when they are earned, and the expenses are recognized when they are incurred, regardless of the timing of related cash flows.

F. ACCOUNTING ESTIMATES

The process of preparing financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenditures. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

NOTE 2 - CASH AND TEMPORARY INVESTMENTS:

Michigan Compiled Laws, Section 129.91 (Public Act 20 of 1943, as amended), authorizes a local governmental unit to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations which have an office in Michigan. The local unit is allowed to invest in bonds, securities and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptance of United States banks; commercial paper rated within the two highest classifications which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan. The Authority's deposits are in accordance with statutory authority and the Authority has no investments as of February 28, 2006.

Custodial Credit Risk of Bank Deposits:

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The Authority's investment policy does not directly address a deposit policy for custodial credit risk. At February 28, 2006 the Authority had \$99,662 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The Authority believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Authority evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution. Only those institutions with an acceptable estimated risk level are used as depositories.

**PORT AUSTIN AREA SEWER AND WATER AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED FEBRUARY 28, 2006 AND 2005
(CONTINUED)**

NOTE 3 - CAPITAL ASSETS:

Capital asset activity for the year ended February 28, 2006, was as follows:

	BALANCE MARCH 1, <u>2005</u>	<u>ADDITIONS</u>	<u>DELETIONS</u>	BALANCE FEBRUARY 28, <u>2006</u>
SANITARY SEWER SYSTEM:				
Capital assets not being depreciated:				
Land - at cost	\$ 51,225	\$ -	\$ -	\$ 51,225
Capital assets being depreciated - at cost:				
Sewer facility planning and system	4,142,886	-	-	4,142,886
Sewer plant	2,200,415	-	-	2,200,415
Equipment	168,126	4,604	500	172,230
Furniture and fixtures	61,706	-	-	61,706
	<u>6,573,133</u>	<u>4,604</u>	<u>500</u>	<u>6,577,237</u>
Less accumulated depreciation:				
Sewer facility planning and system	1,751,052	84,072	-	1,835,124
Sewer plant	946,545	44,513	-	991,058
Equipment	146,331	5,076	304	151,103
Furniture and fixtures	61,201	-	-	61,201
	<u>2,905,129</u>	<u>133,661</u>	<u>304</u>	<u>3,038,486</u>
Total capital assets being depreciated - net	<u>3,668,004</u>	<u>129,057</u>	<u>196</u>	<u>3,538,751</u>
WATER SYSTEM:				
Capital assets not being depreciated:				
Land - at cost	-	-	-	-
Capital assets being depreciated - at cost:				
Water treatment plant	368,446	-	-	368,446
Water tower	146,100	-	-	146,100
Equipment	94,660	600	500	94,760
Water intake	-	-	-	-
	<u>609,206</u>	<u>600</u>	<u>500</u>	<u>609,306</u>
Less accumulated depreciation:				
Water treatment plant	358,134	2,132	-	360,266
Water tower	128,627	2,016	-	130,643
Equipment	88,071	1,329	304	89,096
Water intake	-	-	-	-
	<u>574,832</u>	<u>5,477</u>	<u>304</u>	<u>580,005</u>
Total capital assets being depreciated - net	<u>34,374</u>	<u>4,877</u>	<u>196</u>	<u>29,301</u>
TOTAL CAPITAL ASSETS - NET	<u><u>\$ 3,753,603</u></u>	<u><u>\$ 133,934</u></u>	<u><u>\$ 392</u></u>	<u><u>\$ 3,619,277</u></u>

(Continued)

PORT AUSTIN AREA SEWER AND WATER AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED FEBRUARY 28, 2006 AND 2005
(CONTINUED)

NOTE 3 - CAPITAL ASSETS: (Continued)

Capital asset activity for the year ended February 28, 2005, was as follows:

	BALANCE MARCH 1, <u>2004</u>	<u>ADDITIONS</u>	<u>DELETIONS</u>	BALANCE FEBRUARY 28, <u>2005</u>
SANITARY SEWER SYSTEM:				
Capital assets not being depreciated:				
Land - at cost	\$ 51,225	\$ -	\$ -	\$ 51,225
Capital assets being depreciated - at cost:				
Sewer facility planning and system	4,142,886	-	-	4,142,886
Sewer plant	2,200,415	-	-	2,200,415
Equipment	168,126	-	-	168,126
Furniture and fixtures	61,706	-	-	61,706
	<u>6,573,133</u>	<u>-</u>	<u>-</u>	<u>6,573,133</u>
Less accumulated depreciation:				
Sewer facility planning and system	1,666,980	84,072	-	1,751,052
Sewer plant	901,964	44,581	-	946,545
Equipment	136,630	9,701	-	146,331
Furniture and fixtures	61,201	-	-	61,201
	<u>2,766,775</u>	<u>138,354</u>	<u>-</u>	<u>2,905,129</u>
Total capital assets being depreciated - net	<u>3,806,358</u>	<u>138,354</u>	<u>-</u>	<u>3,668,004</u>
WATER SYSTEM:				
Capital assets not being depreciated:				
Land - at cost	209,645	-	(209,645)	-
Capital assets being depreciated - at cost:				
Water treatment plant	368,446	-	-	368,446
Water tower	146,100	-	-	146,100
Equipment	94,660	-	-	94,660
Water intake	1,475,000	-	(1,475,000)	-
	<u>2,084,206</u>	<u>-</u>	<u>(1,475,000)</u>	<u>609,206</u>
Less accumulated depreciation:				
Water treatment plant	355,839	2,295	-	358,134
Water tower	126,611	2,016	-	128,627
Equipment	84,119	3,952	-	88,071
Water intake	442,949	27,065	470,014	-
	<u>1,009,518</u>	<u>35,328</u>	<u>470,014</u>	<u>574,832</u>
Total capital assets being depreciated - net	<u>1,074,688</u>	<u>35,328</u>	<u>(1,004,986)</u>	<u>34,374</u>
TOTAL CAPITAL ASSETS - NET	<u><u>\$ 5,141,916</u></u>	<u><u>\$ 173,682</u></u>	<u><u>\$(1,214,631)</u></u>	<u><u>\$ 3,753,603</u></u>

(Continued)

**PORT AUSTIN AREA SEWER AND WATER AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED FEBRUARY 28, 2006 AND 2005
(CONTINUED)**

NOTE 3 - CAPITAL ASSETS: (Continued)

Included in expenses were depreciation charges totaling the following:

	<u>2006</u>	<u>2005</u>
Sanitary Sewer Enterprise Fund	<u>\$ 133,631</u>	<u>\$ 138,354</u>
Water Systems Enterprise Fund	<u>\$ 5,477</u>	<u>\$ 35,328</u>

NOTE 4 - ASSESSMENTS RECEIVABLE:

In conjunction with the construction of the sanitary sewer facilities, the Port Austin Area Sewer and Water Authority sold bonds to finance 20% of said construction. To retire these bonds, assessments have been assigned to the benefited properties.

Assessments receivable are carried as accounts receivable from the benefited property owners. The receivables carry an interest rate of 6% and amounted to \$200,840 and \$236,421 at February 28, 2006 and 2005, respectively. The assessments receivable are restricted for payment of the outstanding Sewage Disposal System Limited Tax General Obligation Bonds, which were paid off as of February 28, 2006.

NOTE 5 - LONG-TERM DEBT:

The following is a summary of changes in long-term debt of the Authority's business-type activities for the year ended February 28, 2006:

	BALANCE MARCH 1, <u>2005</u>	<u>ADDITIONS</u>	<u>DELETIONS</u>	BALANCE FEBRUARY 28, <u>2006</u>
SEWER SYSTEM FUND:				
Sewage Disposal System				
Bonds	200,000	-	200,000	-
TOTAL	<u>\$ 200,000</u>	<u>\$ -</u>	<u>\$ 200,000</u>	<u>\$ -</u>

The Sewage Disposal System bonds were paid off during the fiscal year ended February 28, 2006.

(Continued)

**PORT AUSTIN AREA SEWER AND WATER AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED FEBRUARY 28, 2006 AND 2005
(CONTINUED)**

NOTE 5 - LONG-TERM DEBT: (Continued)

The following is a summary of changes in long-term debt of the Authority's business-type activities for the year ended February 28, 2005:

	BALANCE MARCH 1, <u>2004</u>	<u>ADDITIONS</u>	<u>DELETIONS</u>	BALANCE FEBRUARY 28, <u>2005</u>	AMOUNTS DUE WITHIN <u>ONE YEAR</u>
WATER SYSTEM FUND:					
1995 Water Revenue Bonds	\$ 923,000	\$ -	\$ 923,000	\$ -	\$ -
Land contract payable	149,650	-	149,650	-	-
TOTAL WATER SYSTEM FUND	<u>1,072,650</u>	<u>-</u>	<u>1,072,650</u>	<u>-</u>	<u>-</u>
SEWER SYSTEM FUND:					
Sewage Disposal System Bonds	250,000	-	50,000	200,000	50,000
TOTAL	<u>\$ 1,322,650</u>	<u>\$ -</u>	<u>\$ 1,122,650</u>	<u>\$ 200,000</u>	<u>\$ 50,000</u>

The 1995 Water Revenue Bonds and the land contract payable were paid with funds provided by USDA Rural Development through the Huron Regional Water Authority. The Port Austin Sewer and Water Authority transferred the water intake system and land to the Huron Regional Water Authority, with the related debt being paid off by USDA Rural Development funds.

NOTE 6 - WATER SUPPLY SYSTEM MANAGEMENT CONTRACT:

Effective March 1, 1996 the Port Austin Area Sewer and Water Authority entered into a water supply system management contract with the Village of Port Austin and the Township of Port Austin. Major elements of the agreement are as follows:

- The Authority will manage, operate, maintain and administer the water system for the Village and the Township and will comply with all requirements of the Rural Economic and Community Development Agency of the United States Department of Agriculture relative to outstanding Village bonds.
- Rates charged to customers will be recommended by the Authority and adopted by ordinance in each local unit.
- The Authority will prepare the annual budget.
- The Authority will prepare an annual report of its management of the water system and have an annual audited financial report.
- The local units will hold legal title to the system for assets transferred at the onset of the agreement.
- The term of the agreement is 40 years.

Because of the term of the agreement, the former Water Fund in the Village of Port Austin is now being reported upon in the financial statements of the Port Austin Area Sewer and Water Authority.

**PORT AUSTIN AREA SEWER AND WATER AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED FEBRUARY 28, 2006 AND 2005
(CONTINUED)**

NOTE 7 – REGIONAL WATER AUTHORITY MANAGEMENT CONTRACT:

On April 1, 2004 the Village of Port Austin (with which the Authority has an exclusive water supply management contract) and the City of Bad Axe entered into a management contract with a newly formed Huron Regional Water Authority. The purpose of the contract is to supply lake water to the City, the Village and immediate surrounding areas. Major provisions of the 40 year contract include the following:

- 1) Construction of shared facilities, primarily a new treatment plant and a new pumping station.
- 2) The Authority deeded the water intake system and land to the Huron Regional Water Authority.
- 3) The Huron Regional Water Authority paid off bonds related to the intake system totaling \$923,000 and also paid off a land contract on the land totaling \$149,650.
- 4) The Huron Regional Water Authority reimbursed the Authority for \$119,168 of prior period costs advanced.
- 5) The Huron Regional Water Authority will be responsible for operation and maintenance of all shared facilities (water intake, treatment plant and pumping and transmission lines to the local units of government).
- 6) The City of Bad Axe and the Port Austin Area Sewer and Water Authority will purchase water from the Huron Regional Water Authority and will be responsible for their own local distribution and billing.

The facilities at the new Huron Regional Water Authority are expected to be completed by October or November, 2005.

NOTE 8 - SERVICE AGREEMENT:

During the year ended February 28, 2002, the Authority entered into an agreement with Wade-Trim Operations Services to provide operational services. The initial term of the agreement was for three years, commencing June 5, 2001, and has renewal options which have been exercised. The annual base fee at February 28, 2006 for the water system and the wastewater system is \$341,058 (billed \$28,422 monthly). Future adjustments to the contract can be negotiated if the Consumer Price Index exceeds 4% or for a greater than 5% increase in utility rates. Additionally, the Authority will pay for all capital expenditures and will maintain general liability, personal injury and property insurance on the facilities. Major services provided by Facilities Management, Inc. include:

- 1) Day to day operational costs of the water and wastewater system, including labor costs, utility costs and chemical costs.
- 2) Preventative and corrective maintenance and repairs, up to \$40,000 per year.
- 3) Perform reading, billing and collection services.
- 4) Acting as the Authority's liaison with local, state, and federal regulatory agencies.

NOTE 9 – RISK MANAGEMENT:

The Authority is exposed to various risks of loss related to property loss, torts, errors and omissions, employee injuries, and natural disasters. The Authority participates with Michigan Community Underwriters for claims related to property loss, natural disasters, general liability, errors and omissions and auto liability. The Insurer operates as a common risk-sharing management program for governmental units in Michigan. Member premiums are used to purchase insurance coverage and to pay member claims in excess of deductible amounts.

**PORT AUSTIN AREA SEWER AND WATER AUTHORITY
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEARS ENDED FEBRUARY 28, 2006 AND 2005
(CONTINUED)**

NOTE 10 – CONTINGENCY:

On June 8, 2005, the Authority received correspondence from the Department of Environmental Quality at the State of Michigan (D.E.Q.), mandating that the Authority upgrade its facilities to reduce unwanted elements in the discharge of water from its sewage treatment plant.

The timetable for this upgrade is as follows:

- March 31, 2006 – Submit a preliminary engineering report and develop a funding and financing plan.
- October 31, 2006 – Submit final plans for the facility.
- January 31, 2007 – Receive construction bids.
- December 31, 2007 – Complete construction and obtain appropriate operational level.

The cost and funding requirements of this mandate have not been determined at this time.

NOTE 11 – CHANGE IN ACCOUNTING PRINCIPLES AND RESTATEMENT OF FUND EQUITY:

For the year ended February 28, 2005, the Authority implemented GASB Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments. It creates new basic financial statements which now include financial statements prepared on an accrual basis of accounting. Also the statement requires a management's discussion and analysis letter to offer readers a narrative of the financial statements.

SUPPLEMENTARY INFORMATION

PORT AUSTIN AREA SEWER AND WATER AUTHORITY
BUSINESS-TYPE ACTIVITIES
COMBINING STATEMENT OF NET ASSETS
FEBRUARY 28, 2006

	<u>WATER SYSTEM</u>	<u>SEWER SYSTEM</u>	<u>TOTAL</u>
<u>ASSETS</u>			
CURRENT ASSETS:			
Cash and cash equivalents	\$ 222,148	\$ (210,909)	\$ 11,239
Receivables:			
Usage	50,000	37,683	87,683
Special assessment	-	34,154	34,154
Other	19,846	-	19,846
Inventory	11,640	2,347	13,987
Prepaid expense	5,194	11,113	16,307
TOTAL CURRENT ASSETS	<u>308,828</u>	<u>(125,612)</u>	<u>183,216</u>
NONCURRENT ASSETS:			
Investments-savings (restricted)	120,101	68,322	188,423
Special assessments (restricted)	-	165,997	165,997
Capital assets - net of accumulated depreciation	29,301	3,589,976	3,619,277
TOTAL NONCURRENT ASSETS	<u>149,402</u>	<u>3,824,295</u>	<u>3,973,697</u>
TOTAL ASSETS	<u>458,230</u>	<u>3,698,683</u>	<u>4,156,913</u>
<u>LIABILITIES</u>			
CURRENT LIABILITIES:			
Accounts payable	35,872	38,596	74,468
Current portion of deferred assessment revenue	-	34,154	34,154
TOTAL CURRENT LIABILITIES	<u>35,872</u>	<u>72,750</u>	<u>108,622</u>
NONCURRENT LIABILITIES:			
Long-term portion of deferred assessment revenue	-	165,997	165,997
TOTAL NONCURRENT LIABILITIES	<u>-</u>	<u>165,997</u>	<u>165,997</u>
TOTAL LIABILITIES	<u>35,872</u>	<u>238,747</u>	<u>274,619</u>
<u>NET ASSETS</u>			
Invested in capital assets, net of related debt	29,301	3,589,976	3,619,277
Restricted	120,101	68,322	188,423
Unrestricted	272,956	(198,362)	74,594
TOTAL NET ASSETS	<u>\$ 422,358</u>	<u>\$ 3,459,936</u>	<u>\$ 3,882,294</u>

**PORT AUSTIN AREA SEWER AND WATER AUTHORITY
BUSINESS-TYPE ACTIVITIES
COMBINING STATEMENT OF REVENUES, EXPENSES AND
CHANGES IN FUND NET ASSETS
FOR THE YEAR ENDED FEBRUARY 28, 2006**

	<u>WATER SYSTEM</u>	<u>SEWER SYSTEM</u>	<u>TOTAL</u>
OPERATING REVENUES:			
Charges for services	\$ 297,435	\$ 193,511	\$ 490,946
Other	16,628	2,701	19,329
TOTAL OPERATING REVENUES	<u>314,063</u>	<u>196,212</u>	<u>510,275</u>
OPERATING EXPENSES:			
Contractual services:			
Management services	176,946	232,386	409,332
Legal	3,359	-	3,359
Audit and engineering	2,328	11,610	13,938
Board fees	1,190	1,190	2,380
Insurance	6,924	14,635	21,559
Other	7,615	2,718	10,333
Depreciation	5,477	133,661	139,138
Water purchases - Huron Regional Water Authority	15,016	-	15,016
TOTAL OPERATING EXPENSES	<u>218,855</u>	<u>396,200</u>	<u>615,055</u>
OPERATING INCOME (LOSS)	<u>95,208</u>	<u>(199,988)</u>	<u>(104,780)</u>
NONOPERATING REVENUES (EXPENSES):			
Special assessments	-	42,942	42,942
Interest income	1,008	18,884	19,892
Interest expense	-	(6,750)	(6,750)
TOTAL NONOPERATING REVENUES (EXPENSES)	<u>1,008</u>	<u>55,076</u>	<u>56,084</u>
CHANGE IN NET ASSETS	<u>96,216</u>	<u>(144,912)</u>	<u>(48,696)</u>
NET ASSETS - BEGINNING OF YEAR	326,142	3,604,848	3,930,990
NET ASSETS - END OF YEAR	<u>\$ 422,358</u>	<u>\$ 3,459,936</u>	<u>\$ 3,882,294</u>

**PORT AUSTIN SEWER AND WATER AUTHORITY
BUSINESS-TYPE ACTIVITIES
COMBINING STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED FEBRUARY 28, 2006**

	<u>WATER SYSTEM</u>	<u>SEWER SYSTEM</u>	<u>TOTAL</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Receipts from customers and users	\$ 311,566	\$ 188,771	\$ 500,337
Payments to suppliers	(221,139)	(262,348)	(483,487)
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u>90,427</u>	<u>(73,577)</u>	<u>16,850</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:			
Interest expense	-	(6,750)	(6,750)
Payment of borrowing	-	(200,000)	(200,000)
Special assessments received	-	42,942	42,942
Acquisition of capital assets	(600)	(4,604)	(5,204)
NET CASH PROVIDED (USED) BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(600)</u>	<u>(168,412)</u>	<u>(169,012)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sale of investments	-	133,180	133,180
Purchase of investments	(17,678)	-	(17,678)
Interest revenue	1,008	18,884	19,892
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	<u>(16,670)</u>	<u>152,064</u>	<u>135,394</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS DURING THE YEAR	<u>73,157</u>	<u>(89,925)</u>	<u>(16,768)</u>
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	148,991	(120,984)	28,007
CASH AND CASH EQUIVALENTS - END OF YEAR	<u><u>\$ 222,148</u></u>	<u><u>\$ (210,909)</u></u>	<u><u>\$ 11,239</u></u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:			
Operating income (loss)	\$ 95,208	\$ (199,988)	\$ (104,780)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:			
Depreciation	5,477	133,661	139,138
(Increase) decrease in receivables	(2,497)	(7,441)	(9,938)
(Increase) decrease in prepaid expenses	46	57	103
Increase (decrease) in accounts payable	(7,807)	134	(7,673)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u><u>\$ 90,427</u></u>	<u><u>\$ (73,577)</u></u>	<u><u>\$ 16,850</u></u>